

11 USC § 547(c)(2)
11 USC § 547(c)(4)
11 USC § 550(c)

Mitchell v. Pacificorp Credit, Inc. Adv. No. 92-3384-S

In re Hanna Case No. 390-33990-S11

3/1/94

DDS

unpublished

The trustee sued Pacificorp for preferential transfers totaling over \$600,000. The transfers were made within one year of Hanna's chapter 11 filing, the transfers benefitted an insider creditor, HAC. After trial, the court entered judgment in favor of the trustee for \$249,000. The balance was subject to ordinary course of business and new value defenses.

The trustee established the debtor's insolvency during the year before chapter 11 by adequate circumstantial evidence.

Pacificorp satisfied its burden of proof on the ordinary course of business defense as to payments made on Note 4. Those payments were all timely, by check, for loans made in the ordinary course of business of the defendant, of HAC, and of Hanna.

Pacificorp was also entitled to a new value defense to the extent of \$59,569. Pacificorp did not provide sufficient evidence to prove that there was any additional new value "on account of which new value (Hanna) did not make an otherwise unavoidable transfer to or for the benefit of (HAC)". This complicated language found in § 547(c)(4)(B) does not mean "unpaid". Due to the nature of the relationship between Hanna and HAC, the court merged all the transfers between them into a single account. As a result, all transfers by Hanna after new value from HAC were transfers "on account of" the new value that HAC had provided to Hanna. Transfers by Hanna to HAC were otherwise unavoidable for various reasons, and eliminated most of the new value defense.

Pacificorp did not prove that the Hanna estate received a satisfaction from the HAC estate for the transfers at issue.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case Nos.
)	390-33990-S11
DANIEL C. HANNA, et al,)	390-34210-S11
)	390-34211-S11
Debtors,)	(Administratively
)	Consolidated)
JOHN MITCHELL, INC.,)	
Trustee of the Hanna)	Adversary Proceeding No.
Liquidating Trust,)	92-3384-S
)	
Plaintiff,)	MEMORANDUM OPINION
)	
v.)	
)	
PACIFICORP CREDIT, INC.,)	
an Oregon corporation,)	
)	
Defendant.)	

John Mitchell, Inc., as Trustee of the Hanna Liquidating Trust ("Trustee") filed this suit to avoid preferential transfers made for the benefit of Hanna Acceptance Corporation ("HAC"), an insider, and to recover the amount avoided from Pacificorp Credit Inc. ("Pacificorp") as the initial transferee. Several issues in the case were disposed

of on motions for summary judgment, and the remaining points were tried on February 8, and 9, 1994, followed by oral argument on February 16, 1994. The Trustee proved all the elements of 11 U.S.C. § 547(b)¹ with respect to payments totalling \$612,488. Pacificorp established that \$303,125 of the total is not avoidable because the payments were made in the ordinary course of business. Pacificorp is also entitled to a new value defense for \$59,569.00. Judgment should be entered in favor of the trustee and against Pacificorp for \$249,794. My reasons follow.

Many of the facts and my earlier rulings are set forth in a memorandum disposing of summary judgment motions which was issued on November 18, 1993. All the findings of fact and conclusions of law which were included in the November 18 ruling, as well as a memorandum and order entered on February 26, 1993 and oral findings made on April 30, 1993 are hereby adopted and included in this final ruling.

The transfers under consideration are checks written by the debtor, Daniel C. Hanna ("Hanna"), and were transfers of his property to Pacificorp. All of the payments were made more than 90 days and less than one year before Hanna filed chapter 11. Pacificorp received the funds as payments on two separate

¹ Unless otherwise stated, all statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101 et. seq.

types of loans that it made to HAC. HAC loaned the money to Hanna, and was an insider creditor of Hanna.

Hanna owned and controlled HAC, a corporation that provided financing for Hanna to build, sell and operate car washes. HAC borrowed money from individuals and corporations to raise much of the capital that it loaned to Hanna. Pacificorp loaned \$5 million to HAC in the summer of 1987. That transaction is referred to as Note 4. The interest on Note 4 was paid quarterly by U.S. Bank, the disbursing agent, and the principal was due in the summer of 1990. Hanna wrote many of the checks to U.S. Bank for the interest during the year before he filed chapter 11. U.S. Bank paid the money to noteholders, and Pacificorp received \$303,125 of the money represented by Hanna's checks.

Pacificorp also loaned HAC \$2,250,000 in October 1988. Hanna guaranteed the loan, which is referred to as Note 3. Hanna granted Pacificorp a second trust deed against eight car washes to secure the Pacificorp loans to HAC and Hanna. At the time of the Note 3 loan, Hanna also signed a guaranty for repayment of Note 4. During the extended preference period, Hanna paid at least \$309,363 to Pacificorp on Note 3. Hanna filed chapter 11 on July 27, 1990. HAC was Hanna's largest creditor, and Hanna was HAC's major source of cash. When Hanna was no longer able to make payments to HAC, HAC could not meet

the obligations on the notes to Pacificorp and others. HAC filed its own chapter 11 on August 10, 1990.

THE TRUSTEE'S CASE

The trustee met his burden of proof on the elements of § 547(b). Most of the § 547(b) issues were decided in the ruling on summary judgment which was entered on November 18, 1993. The issues Pacificorp pursued to trial were whether Daniel Hanna was insolvent on the date of the transfers at issue, and the "greater percentage" test of § 547(b)(5).

Pacificorp also added the argument that HAC was not a separate entity from Hanna because the trustee showed that Hanna had deposited money into HAC's bank accounts in the two months before filing chapter 11. A plan of reorganization was confirmed in each chapter 11, and the debtors were not consolidated. Hanna's use of HAC's checking account during his slide into bankruptcy is not sufficient evidence to now hold that HAC was not a separate entity.

Insolvency

The trustee adequately established that Hanna was insolvent during the year before this chapter 11 case was filed. Although Mitchell could not say precisely how insolvent Hanna was on any particular date, he provided circumstantial evidence to show that Hanna was insolvent by several million

dollars at all times between September 1989 and July of 1990. This conclusion is supported both by the assets and liabilities that existed on the date of the chapter 11, the fact that the operating and investment losses were not sufficient to account for the enormous discrepancy between the balance sheets in 1988 and 1989, and reality in 1990 as evidenced by the disclosure statements. The trustee's analysis in Exhibit 20 is logical and reasonable.

Greater Percentage Test § 547(b) (5)

The trustee also established that neither HAC nor Pacificorp were fully secured creditors, and that the unsecured creditors in the Hanna case would have received very little, if anything had Hanna filed chapter 7 instead of chapter 11. The trustee proved that HAC and Pacificorp received more as a result of the transfers at issue than they would have received had the payments not been made, the case were a case under chapter 7 and had they received payment to the extent provided by the bankruptcy code. 11 USC §547(b) (5), In re Lewis W. Shurtleff, 778 F.2d 1416, 1421 (9th Cir. 1985), Palmer Clay Products Co. v. Brown, 297 U.S. 227 (1936).

In addition, the terms of the plan granted standing to John Mitchell, Inc. to pursue this lawsuit as the liquidating trustee. To the extent that the transfers are avoidable under § 547, the trustee may recover that amount from Pacificorp as

the initial transferee of the payments under § 550 and Official Unsecured Creditors Committee v. U.S. National Bank of Oregon (In re Sufolla, Inc.), 2 F.3d 977 (9th Cir. 1993).

PACIFICORP'S DEFENSES

Pacificorp raised three defenses to the preference suit. The first was that the payments on Note 4 were made in the ordinary course of business as that term is defined in § 547(c)(2). The second was that HAC, the benefitted insider creditor, provided sufficient new value after the transfers to defeat avoidability under § 547(c)(4). The third was that the Hanna estate had already received a single satisfaction of this claim through its settlement with the HAC estate, and is prevented from further recovery under § 550(c). Pacificorp has the burden of proving the nonavoidability of the transfers. § 547(g).

Ordinary Course of Business Defense

Pacificorp proved all the elements of the ordinary course exception as to the payments on Note 4. That exception focuses on the ordinary course of the debtor, Hanna, and the transferee, Pacificorp. HAC loaned Hanna the proceeds of Note 4. Such a loan was in the ordinary course of business of Hanna. I ruled on summary judgment that Hanna was making payments on his own loan from HAC, rather than on the guaranty of HAC's debt to Pacificorp. HAC would not be a creditor of

Hanna if Hanna were paying because of his guaranty, and the trustee would not be entitled to recover payments made during the extended preference period. Hostmann v. First Interstate Bank of Or. (In re XTI Xonix Corp), 156 Bankr. 821 (Bankr. D. Or. 1993) and Levit v. Ingersoll Rand Financial Corp., (In re V.N. Deprizio Construction Co.), 874 F.2d 1186, 1191-92 (7th Cir. 1989). The fact that Hanna executed the guaranty for Note 4 more than a year after the loan was made is not particularly relevant in determining that the loan from HAC to Hanna was ordinary.

Although it was unusual for Pacificorp to make unsecured loans, the record is adequate to find that the Note 4 loan to HAC fell within the ordinary course of Pacificorp's business. Pacificorp was expanding its operation, and considered a long term financing arrangement with Hanna to be an attractive opportunity. Financing car washes was consistent with other Pacificorp investments.

The evidence about the loan being approved at a cocktail party was not strong enough to withstand the testimony and exhibits indicating Pacificorp's investigation of the loan. The omission of Mr. Hayward from the approval chain did not bring the loan outside the ordinary course of Pacificorp's business. The chain of command and approval process were being restructured during the summer that the Note 4 loans were made,

and it appears that the loan was otherwise approved within normal procedures.

Finally, the payments were made according to ordinary business terms. The payments were made on time and by check. Although the checks to U.S. Bank for the interest payments were from several different Hanna entities and HAC, that was typical of the way Hanna paid bills.

Pacificorp proved that the trustee may not avoid the \$303,125 payments on Note 4 by virtue of § 547(c)(2), In re Food Catering & Housing Inc., 971 F.2d 396 (9th Cir. 1992), and In re Loretto Winery, Ltd., 107 Bankr. 707 (Bankr. 9th Cir. 1989).

New Value Defense

Pacificorp also claims that Hanna received sufficient subsequent new value from HAC to defeat the preference under § 547(c)(4). Pacificorp did not meet its burden of proof on this issue, except to the extent of \$59,569, the sum of the seven positive numbers on pages 7 and 8 of Exhibit 54.

Pacificorp itself provided no new value to Hanna after the preferential transfers were made. However, in a "Deprizio" case such as this, the initial transferee may rely on subsequent new value provided by HAC, the insider creditor, to the debtor. In denying Pacificorp's motion for summary judgment on this issue, I informed the parties that I did not

interpret the language of § 547(c)(4)(B) to be limited to the meaning "unpaid". I agree with and adopt the thoughtful analysis provided in cases such as In re Check Reporting Services, Inc., 140 Bankr. 425 (Bankr. W.D. Mich. 1992), Mosier v. Ever-Fresh Foods Co. (In re IRFM, Inc.), 144 Bankr. 886 (Bankr. C.D. Cal. 1992) and Successor Comm. of Creditors Holding Unsecured Claims v. Bergen Brunswick Drug Co., (In re Ladera Heights Community Hosp. Inc.), 152 Bankr. 964 (Bankr. C.D. Cal. 1993).

Unfortunately, the relationship between HAC and Hanna was not the typical open account between a supplier and a debtor. John Mitchell and others testified that Hanna's records were essentially worthless. HAC created several accounts to record intercompany transfers. Pacificorp argued that these accounts should be viewed separately, and the requirements of § 547(c)(4)(B) were fulfilled because it could show that no payments were made on certain accounts.

Pacificorp offered three different categories of advances from HAC to supply the new value. One type consisted of three promissory notes executed by Hanna in December 1989. The three notes totalled \$760,000 and represented money that was borrowed from the Hanna Employees' Pension Fund. The second category was referred to as the 111 Accounts. These were cash advances HAC made to Hanna when Hanna received an

order for a car wash. The final category was a series of checks written by HAC to Hanna in June 1990.

The June transfers do not constitute new value. The trustee proved that the money represented by those checks was actually Hanna's money. Hanna was using HAC's checking account during the two months before bankruptcy. He would deposit checks into the HAC account and then have HAC write checks back to him. Based on Hanna's control over HAC, the Hanna money in those accounts was not actually HAC's property. If it was, it was intended as a contemporaneous exchange for the new checks.

Pacificorp presented evidence to show that there were no payments made to reduce the principal balance on the \$760,000 notes. It also provided the ledger cards for various 111 customer accounts. The cards show that HAC advanced money to Hanna after the preferential transfers at issue, and that some of these accounts had an outstanding principal balance remaining at the time Hanna filed chapter 11. Pacificorp relies on this evidence to show that there were no "otherwise unavoidable transfers" made by Hanna on these items of new value.

Under the facts of this case, it is more appropriate to combine all of the transactions between Hanna and HAC into a single account than to view them separately. The HAC records support the combination approach. HAC maintained Account 204

to keep track of intercompany transfers. Account 204 shows that while the principal balance on the \$760,000 notes remained unpaid, HAC would charge interest on those notes to Hanna through Account 204. The same was true of the 111 Accounts. The ledger cards supplied by Pacificorp were devoid of reductions to the principal balance, but interest on the outstanding balance was billed through Account 204. In addition to the treatment of the intercompany transactions in Account 204, it is inappropriate to keep accounts such as these segregated because of the possibility for manipulation by the debtors.

When the accounts are merged, then all subsequent transfers by Hanna to HAC should be viewed as transfers "on account of" new value that HAC provided to Hanna. If the transfers from Hanna to or for the benefit of HAC are "otherwise unavoidable", then the new value HAC provided before the otherwise unavoidable transfer is reduced by the amount of the otherwise unavoidable transfers. Pacificorp did not prove that these three categories of transfers were new value "on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of"... HAC.

The net preference exposure between the estates does not fit the DePrezio analysis. When \$ 550 is involved, it is important to focus on the particular transfers at issue, not

just the bottom line. Therefore, Exhibits 48 and 49 do not provide the answer. The trustee provided Exhibit 54, which contained a useful summary of the transfers between Hanna and HAC that occurred after the first preferential payments on Note 3. The chart and supporting documents indicate that Hanna did make otherwise unavoidable transfers to or for the benefit of HAC after the new value relied on by Pacificorp in an amount that is sufficient to eliminate most of the new value.

Some adjustments to Exhibit 54 were required due to the determination that timely payments on the Note 4 interest were within the ordinary course of business, and therefore are "otherwise unavoidable" transfers within the exception to the new value defense in § 547(c)(4)(B). This analysis applies both to the payments made by Hanna, and the payments made by HAC. The interest payments HAC made to U. S. Bank for Note 4 and related notes was not new value to the Hanna estate. HAC was the primary obligor on the notes. The interest payments did not replenish the Hanna estate. They were not avoidable by HAC as preferences because the payments were made in the ordinary course of business. The only new value those payments provided Hanna was a reduction in his liability to Pacificorp. The HAC note 4 payments should be deleted from the new value column.

Pacificorp did not supply any evidence to rebut the

trustee's showing that the Hanna payments listed in the first column of Exhibit 54 were made either in the ordinary course of business or were contemporaneous exchanges, and therefore are "otherwise unavoidable" transfers. After adjusting Exhibit 54 to increase the otherwise unavoidable column by the payments Hanna made on Note 4 in the ordinary course of business and eliminating the HAC payments toward note 4 from the new value column, the only new value that was not eliminated by column 1 transfers are the seven positive numbers found on pages 7 and 8 of Exhibit 54, which total \$59,569.

Exhibit 54 does not include the \$760,000 as new value. The trustee argues that the \$760,000 does not constitute new value because it was money from a loan to an insider prohibited under federal law as a breach of Hanna's fiduciary duty as a trustee of the pension plan. The evidence provided in this area was limited. However, even if the \$760,000 was new value from HAC, that new value was also swallowed up by the transfers in column 1, after the ordinary course payments on Note 4 are adjusted in both the Hanna and HAC columns. Pacificorp had the burden of proof on this complex issue of new value, and did not meet that burden beyond the \$59,569.

Single Satisfaction

Pacificorp's final defense was that the trustee has already received a satisfaction of the preferential transfers

through the settlement of the claims between the Hanna and HAC estates, and therefore is barred by § 550(c) from further recovery on these transfers. This issue was discussed in the November 18 memorandum. Pacificorp refers to the case of Harrison v. Brent Towing Co., Inc. (In re H & S Transportation Co., Inc.), 939 F.2d 355 (6th Cir. 1991), for the proposition that a settlement with an insider, co-obligor under § 550 necessarily results in a satisfaction of the liability for the non-insider defendant. H & S did not involve the extended preference period or the liability of an insider. The H & S debtor operated a boat and paid antecedent debts for fuel during the 90 day preference period. The H & S trustee sued the owner of the boat and the fuel suppliers to recover the preferential payments. In the reported case against the boat owner, the court stated that it was clear that the trustee had already received its entitlement to only a single satisfaction from the two fuel suppliers with whom he settled. H & S does not state how much the trustee received from the settling defendants or provide any further analysis. If the fuel suppliers had already paid the trustee for the avoidable amounts, then the court was merely preventing the trustee from obtaining a double recovery. H & S is not broad enough to apply to the settlement of claims between two chapter 11 estates without a showing of the dollar benefit to the Hanna

estate.

At trial, Pacificorp tried to elicit some testimony from Mr. Mitchell to define the amount the Hanna estate recovered from the settlement with the HAC estate for these preferential transfers. The savings in litigation expenses is not a satisfaction of the obligation. It was not clear how the balance of the numbers discussed constituted a satisfaction of the avoidable transfers at issue here, so Pacificorp did not establish that these claims were already satisfied.

CONCLUSION

A separate judgment will be entered in favor of the trustee and against Pacificorp in the amount of \$249,794.

DONAL D. SULLIVAN
Bankruptcy Judge

cc: Brad T. Summers
Richard C. Josephson